United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-1023

United States Court of Appeals
FOR THE SECOND CIRCUIT

1050 TENANTS CORP., HERBERT SALTZMAN and JOAN SALTZMAN,

Plaintiffs-Appellees,

against

PETER JAKOBSON, JOHN R. JAKOBSON, ARTHUR D. EMIL and LAWRENCE A. KOBRIN,

Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANTS-APPELLANTS

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Defendants-Appellants.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANTS-APPELLANTS

Issue Presented

Whether the sale of 60 residential apartments in a luxury residential apartment building located at 1050 Park Avenue, New York, New York, converted to cooperative ownership under the provisions of New York State law relating to offering of interests in real estate, and in a manner designed to comply with Section 216 of the Internal Revenue Code, necessarily involves the sale of "securities" within the meaning of the federal securities laws (Securities Act of 1933 and Securities Exchange Act of 1934).

Statement of the Case

This is an appeal by the defendants from an order of the United States District Court for the Southern District of New York (Stewart, J.) filed on October 11, 1973, which denied defendants' motion to dismiss plaintiffs' complaint for lack of federal jurisdiction. On November 5, 1973, the District Judge added to the order the certifying language under 28 U.S.C. § 1292(b), pursuant to which defendants then petitioned this Court for leave to take an interlocutory appeal. That petition was granted on December 21, 1973.

Plaintiffs and defendants agreed below that there is subject matter jurisdiction in the United States District Court only if the transaction involved the sale of "securities" as defined in the federal securities laws. Defendants contend that the sales made involved the purchase and sale of real estate, i.e. apartments in a cooperative apartment building, and were not sales covered by the federal securities laws. The resolution of this question will be completely dispositive of this appeal.

Statement of Facts

1050 Park Avenue is a luxury residential apartment building. It is located on Park Avenue in Manhattan, at 87th Street, in what is generally considered to be a fashionable and desirable area of Manhattan.

The building contains 60 residential apartments and four doctor's offices (App. 40a).[1] It was completed in 1923 (App. 67a) and was thereafter continuously occupied as a residential apartment building on a rental basis.

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[1] Citations to the appendix are referred to as "App." followed by the page number.

Appellants held fee title to the building and determined to sell the building. They undertook to do so by converting the building to cooperative ownership and selling the apartments in the building to individuals for residence purposes (App. 28a-29a).

Under such ownership, each apartment owner would own his own apartment and all the owners would share jointly in common building expenses and in building management.[2] There were four doctor's offices not offered

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[2] The cooperative ownership of residential apartments gained exceptional popularity in New York City during the years following World War II. The cessation of construction of housing units during the war created a housing shortage and considerable pressure for residential apartments particularly in more stable neighborhoods. The desire on the part of tenants to have longer term control over their living accommodations than could be afforded under rental arrangements in a "tight" rental market, combined with the impact of rent control statutes on the investment return available from the ownership of multiple dwelling residential buildings, both contributed to the great number of cooperative conversions.

Such cooperative ownership arrangements were not previously unknown. In other countries, the condominium format served as the vehicle by which a group of tenants, whether of residential or office space, might jointly own a structure larger than any of them would individually require. (In fact, that form of ownership now appears to be gaining popularity in the United States and in New York City itself.) For a variety of historical reasons, however, in the United States, and particularly in New York City, the arrangements for the cooperative vehicle by which a larger group of tenants in a given building might join in such ownership was the cooperative apartment corporation.

An important encouragement to this development was the enactment in 1942 of Section 216 of the Internal Revenue Code, originally enacted as Int. Rev. Code of 1939, § 23(z) and included in subsequent reenactments of the Code. The Code provision was designed to give to owners of apartments in multiple dwellings the same tax treatment for federal income tax purposes as was afforded to owners of individual homes. Under that Section, an apartment owner in a qualified cooperative apartment venture was entitled to deduct his proportionate share of the mortgage interest

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for sale, but there was no commercial or rental space in the building (App. 40a).

In order to effect the conversion to cooperative ownership, appellants followed the generally accepted[3] means for such apartment buildings.

The owners of the building prepared for filing with the Department of Law of the State of New York and subse-

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and taxes paid for the building of which his apartment was a part—both items representing deductions to which owners of individual homes would normally be entitled.

A variety of considerations made it convenient to use the corporate form as well. The need for protection against possible liabilities and the necessity for some recognized format for centralized management confirmed the use of the corporate form over alternative possibilities of unincorporated associations (such as a homeowner's association), partnerships, joint ventures, or the like. It has been suggested that the partnership form would not be an appropriate vehicle in New York and in most other states using the Uniform Partnership Act, in light of the requirement that a partnership be formed to carry on a business "for profit". New York Partnership Law, Section 10(1). Regardless of the form used, however, the essential aim was the ownership by the individual tenants of their own apartments and their joint ownership of those common elements in the building and structure which were not a part of any specific apartment.

[3] The "conversion" to cooperative ownership of residential apartment buildings has been so wide-spread in Manhattan that in many areas along Park Avenue, Fifth Avenue or Central Park West, there are few buildings not subject to such cooperative ownership. In fact, the building in the case at bar was one of the last in its immediate area to be so "converted." The popularity of the device of cooperative "conversion" of residential apartment buildings which were subject to rent control required in New York City the addition of a special provision of the Rent Regulations to regulate the manner of conversion. Section 55 of the Rent and Eviction Regulations of the Division of Housing and Community Renewal (McK. Unconsol. Law Appendix § 55) is applicable generally in New York State. In New York City, Section 55 of the New York City Rent, Eviction and Rehabilitation Regulations is applicable. The Code of the Real Estate Industry Stabilization Association of New York City, Inc., Section 61, contains a similar provision, although it is not relevant in the case at bar.

quent presentation to the tenants an offering plan, prepared in accordance with the applicable New York State Law, the so-called Real Estate Syndication Act (McK. Gen. Bus. Law § 352 et seq.) (App. 33a et seq.). That offering plan set forth a description of the mechanics for ownership by the individuals of their residential apartments.

Under the Plan, individual tenant-owners were to own their apartments under proprietary leases[4] with a corporate entity in which the tenant-owners were to hold "stock." Title to the building in which the apartments were located was to be owned by a corporate entity formed under the Plan (App. 63a-64a), and known by a name drawn from the building address, 1050 Tenants Corp. While formed under the New York Business Corporation Law, the corporation was a truncated and limited one. Its activities were limited to the ownership on a cooperative basis of the building at 1050 Park Avenue, New York (App. 47a, 31a). The corporation could not conduct any other business. No dividends or other benefits could be paid to the shareholders of the corporation (App. 47a, 106a-107a).

The corporation by-laws reflected extensive restrictions on the transferability of the shares. These were reflected on the "stock certificates" issued to apartment owners (App. 108a).

The actual ownership of the individual apartments by purchaser-owners was governed by a proprietary lease (the "Lease"). This document was summarized in the Offering Plan (App. 48a-51a), and was executed by each of

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[4] The form of lease ordinarily used is generally denominated a "proprietary lease." While no case or other authority can be found in point, it would appear that this appellation derives from the ownership participation in the lessor entity of the individual tenant-owners.

the purchasers of apartments. A copy of the Lease is reprinted in full in Appendix, pp. 110a et seq.

The Lease was a real estate ownership document designed to cover multiple ownership within a single physical structure of the various apartments. It fixed the arrangement for contributions by individual apartment owners to the cash needs of the building for its common expenses, such as labor, fuel, taxes, mortgage carrying costs, decoration of common areas, and the like (App. 80a, 115a-116a).

The Lease restricted the use of any space in the building to use as a private dwelling (App. 121a-122a). It allocated responsibility between individual apartment owners and the common fund for repairs to plumbing, floors, electrical appliances and other components (App. 117a-118a, 120a, 124a-127a), and made provision which would prevent individual apartment owners from imposing financial burdens, by liens or otherwise, on the building structure itself (App. 128a-130a). The Lease imposed restrictions on subletting (App. 122a-123a).

The Lease set forth a complex set of restrictions and requirements for such transfer of ownership rights to the apartments.[5] Such transfer could only be made upon

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[5] In point of fact, that requirement was frequently an inducement to the tenants to purchase their apartments as cooperative owners in order to exact some greater measure of control over their neighbors than could ever be possible in a normal rental circumstance. The state courts have upheld the almost arbitrary right of tenant representatives to refuse consent (absent statutory discrimination which is prohibited) to proposed transfers and new tenancies. See *Weisner* v. *791 Park Ave. Corp.*, 6 N.Y. 2d 426, 190 N.Y.S. 2d 70 (1959).

The provision in the Lease imposing these requirements and restrictions is Paragraph 16, which reads as follows:

"The Lessee shall not assign this lease or transfer the shares appurtenant thereto or any interest therein, and no such as-

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execution of documents outlined in the Lease and after approval by either the Board of Directors representing the owners or the owners themselves (Lease, ¶ 16, App. 123a-124a). No purported assignment of the Lease or of occupancy rights for the apartments could be made without simultaneous transfer of the "stock" (App. 123a); con-

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signment or transfer shall take effect as against the Lessor for any purpose, until—

(a) An instrument of assignment executed and acknowledged by the assignor shall have been delivered to the Lessor;

(b) An agreement by the assignee assuming and agreeing to perform and comply with all the covenants and conditions of this lease to be performed or complied with by the Lessee on and after the effective date of said assignment shall have been executed and acknowledged by the assignee and delivered to the Lessor, but no such assumption agreement shall be required if the assignee surrenders the assigned lease and enters into a new lease for the remainder of the term, as hereinafter provided;

(c) All shares of the Lessor appurtenant to this lease shall have been transferred to the assignee, with proper transfer stamps affixed;

(d) All sums due from the Lessee shall have been paid to the Lessor, together with a sum to be fixed by the Board of Directors of the Lessor to cover reasonable legal and other expenses of the Lessor in connection with such assignment and transfer of shares;

(e) Except in the case of an assignment, transfer or bequest of the lease and appurtenant shares to the Lessee's spouse, consent to such assignment shall have been duly authorized by resolution of the Board of Directors, or given in writing by a majority of the then authorized number of Directors or, if the Directors shall have refused such consent, then by lessees owning of record at least a majority of the shares of the Lessor then issued and outstanding.

If the Lessee is the Sponsor named in the Plan of Cooperative Organization or a nominee of the Sponsor or Assignee of the Sponsor (who while entitled to occupy any such apartment for his personal use does not do so), then consent to an assignment or transfer of the lease and the shares appurtenant thereto will be required only from the then managing

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versely, no sale or assignment of the "stock" could be made without the transfer of the Lease and the ownership of the apartment (Lease, ¶ 40, App. 139a-140a). In fact, an attempt to divide the ownership of "stock" and Lease was an event of default under the Lease and could result in its termination (Lease ¶ 40, App. 139a; see also Lease ¶ 34(a) and ¶ 38, App. 136a).[6] These restrictions were summarized in the Offering Plan itself (App. 49a-50a).

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agent of the Building, who shall consent to such assignment or transfer only when the assignee or transferee is a reputable person of good financial standing.

Whenever the Lessee shall, under the provisions of this lease, be permitted to assign and shall so assign the same, and the assignee shall assume all of the unfulfilled obligations of the assignor hereunder, either by an instrument in writing delivered to the Lessor or by surrendering the assigned lease and entering into a new lease for the remainder of the term, the assignor shall have no further liability on any of the covenants of this lease to be thereafter performed. At the option and election of the Lessor any assigned lease shall be cancelled, and a new lease for the remainder of the term of this lease, in the same form, shall in such case be entered into between the Lessor and the assignee.

Regardless of any prior consent theretofore given, neither the Lessee nor his executor, administrator or personal representative, nor any trustee or receiver of the property of the Lessee, nor anyone to whom the interest of the Lessee shall pass by law, shall be entitled to assign this lease, to sublet or to occupy the apartment, or any part thereof, except upon compliance with the requirements of this lease. The character of and restriction on the occupancy of the apartment, and on subletting or assignment of this lease, as hereinbefore expressed, restricted and limited, are an especial consideration and inducement for the granting of this lease by the Lessor to the Lessee." (App. 123a-124a)

[6] The Lease itself reflects the unique nature of the "stock" issued in connection with apartment ownership. Paragraph 40 of the Lease provides as follows:

"The shares of the Lessor held by the Lessee and appurtenant to this lease have been acquired and are owned subject to the following conditions agreed upon with the Lessor and

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The Lease provided for the possibility of the inability or failure of individual owners to contribute their share of the common fund expenses or of some other violation of

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with each of the other proprietary lessees for their mutual benefit:

(a) The shares represented by each certificate are transferable only as entirety and simultaneously with the transfer of the proprietary lease to which they are appurtenant;

(b) Neither the Lessee nor the Lessee's personal representatives shall sell or transfer said shares except to the Lessor or or an assignee of this lease after compliance with all of the provisions of paragraph 16 of this lease relating to assignments;

(c) The Lessor shall at all times have a first lien upon the shares owned by each lessee for all indebtedness and obligations owing by such lessee to the Lessor arising under the provisions of any proprietary lease issued by the Lessor and at any time held by such lessee or otherwise arising. The Lessor may refuse to consent to the transfer of shares of any lessee indebted to the Lessor unless and until such indebtedness is paid;

(d) The Lessor shall be entitled to treat the holder of record of any share or shares as the holder in fact thereof, and accordingly, shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, other than executors or administrators of the Lessee, whether or not it shall have express or other notice thereof, except as expressly provided by the laws of New York;

(e) No shares will be outstanding which are not held by proprietary lessees. The right to vote such shares shall cease when the proprietary lease to which such shares are allocated is no longer in effect and such apartment is no longer under lease to the proprietary lessee." (App. 139a).

Conversely, the certificate for "stock" which was issued as a title ownership document includes similar limiting and restricting language:

"The rights of any holder hereof are subject to the provisions of the by-laws of 1050 Tenants Corp. and to all the terms, covenants, conditions and provisions of a certain proprietary lease made between the person in whose name this certificate is issued, as Lessee, and 1050 Tenants Corp., as Lessor, for an

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their responsibility as apartment owners and residents. In such events a termination of ownership rights was to be effected. This could take place in the event of an improper transfer of "stock" (Lease, ¶ 34(a), App. 132a), bankruptcy of the owner (Lease, ¶ 34(b), App. 132a-133a), improper assignment or subletting not in compliance with the Lease (Lease, ¶ 34(c), App. 133a), a default in performance by an individual owner or his objectionable conduct (Lease, ¶ 34(d) and (e), App. 133a-134a), or a determination to terminate all proprietary leases in the building (Lease, ¶ 34(f), App. 134a).

Appellants then arranged to obtain from a real estate management firm experienced in conversion of apartments to cooperative ownership (App. 64a), schedules of allocation of "shares" to various apartments in the building (App. 75a-78a). These allocations were, under the applicable provisions of Section 216 of the Internal Revenue Code, based upon the relative "value" of the apartments to be sold, and included consideration of their size, floor location, number of rooms, and other amenities (App. 54a-55a).

Appellants also obtained an engineering description of the building structure from a consulting engineer (Plan,

(footnote continued from preceding page)

apartment in the premises known as 1050 Park Avenue, New York City, N.Y., which Lease limits and restricts the title and rights of any transferee hereof. The shares represented by this certificate are transferable only as an entirety and only to an approved assignee of such proprietary lease. Copies of the proprietary lease and the by-laws are on file and available for inspection in the office of 1050 Tenants Corp., New York City, N.Y.

"The directors of this corporation may refuse to consent to the transfer of the shares represented by this certificate until any indebtedness of the shareholder to the corporation is paid. The corporation, by the terms of said by-laws and proprietary lease, has a first lien on the shares represented by this certificate for all sums due and to become due under said proprietary lease." (App. 109a).

Schedule A, App. 67a-71a).[7] As a result of negotiations with tenants,[8] an additional engineering report was obtained by the tenants and was included in the Plan under which the sales of apartments were consummated (App. 72a-74a).

After completion of the pre-filing and review procedures of the New York State Department of Law,[9] the Plan was filed under the statute and distributed to the tenants.

The form of Plan was devoted principally, and almost exclusively, to the real estate interests to be conveyed to apartment purchasers. A copy of the Plan in the form in which it was finally amended prior to closing of the real estate transactions appears in the Appendix beginning at 33a. The Plan covered in detail a description of the physical surroundings and structural components (App.

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[7] In an offering plan originally presented (see Plan, App. 39a), only this report obtained by appellants was included. In response to that presentation, the tenants to whom the Plan was presented themselves organized a negotiating committee and obtained an additional report from another engineering firm, J. G. White Engineering Corporation (App. 40a). An extract from that report obtained by the tenants was included in the amended Plan under which the sale was consummated (App. 72a-74a).

[8] Such a development, while not reflected in the statutory material regarding cooperative "conversions," is a normal feature of such undertakings, particularly in a building similar to the case at bar, where a relatively small number of tenants in higher economic circumstances is able to organize for the purposes of negotiation with representatives of the sponsor of the offering plan.

[9] As implemented at the time of the case at bar, and subsequently, that Act required that the New York State Department of Law review prior to its distribution to offerees, any offering literature to be used in soliciting purchases of apartments by tenants or others in connection with a "conversion" to cooperative ownership. Only after (1) that review, (2) changes in the offering material based upon the recommendation or suggestions of the Department of Law staff, and (3) compliance with applicable regulations and practice, was the offering literature accepted for "filing" and could then be distributed.

39a-44a, 67a-74a), the prices and summary description of the individual apartments offered for sale (App. 75a-79a), the rights of tenants under applicable local rent control statutes (App. 44a-46a, 83a-88a), the possibility of apartment price changes (App. 46a-47a), the form of Leases and ownership documents (App. 48a-51a), the mechanics for the purchase of apartments and for closing (App. 51a-52a, 60a-63a, 89a-96a), the proposed operating budget and historical accounting information (App. 52a-54a, 80a-82a), income tax deductions under Section 216 (App. 54a-55a), the finances and mortgages on the building structure (55a-60a), and additional general information required by the New York statute (App. 62a-66a).

In fact, in a 65-page printed document, only one page made reference to the corporate structure of the vehicle to be used for title holding purposes (App. 47a-48a); the bulk of the information furnished to tenants and prospective purchasers related only to real estate—the building and the apartments (App. 30a-32a).

While the Plan anticipated the possibility that transfer of title to the building might take place before all the apartments were actually sold, and providing contingently for some measure of involvement by the sponsors in the management of the building in such event (App. 48a and 60a), by the time that title was scheduled to be transferred, all of the apartments had been sold to tenants or to other purchasers, and on January 30, 1969 the transfer of title took place (App. 29a). On that date, appellant-sponsors, the then owners of the building, delivered a deed for the building to the new owning entity—1050 Tenants Corp. (App. 30a). From that moment on the sponsors did not participate in any way in the management of the building. The individual purchasers paid their purchase prices for their apartments which were used primarily to pay the purchase price for the building to the owners and also to

furnish initial working capital and a reserve or repair fund for the building itself (App. 55a-56a). The companion title documents—the proprietary lease and the certificates for "shares"—were issued to the new tenant-owners. Thereafter, the tenant-owners met and elected their own representatives to constitute a board of directors to manage the property under cooperative ownership (App. 30a).

Long after the transfer of title (See Answer, ¶ 25, App. 24a), certain of the tenant owners claimed that contents of the offering plan were erroneous. The claims related to such matters as estimate of repair or operating costs, the state of mind of the building superintendent, and similar details (App. 12a-14a).

This action was commenced, purportedly as a class action on behalf of all present and former owners. In the action, the plaintiffs claimed that the offering to them constituted an offering of "securities" as defined in the federal securities law and that there was accordingly proper jurisdiction in the United States District Court for the resolution of this dispute, absent diversity or other grounds for such jurisdiction. Appellants-defendants moved to dismiss, the Court below denied that motion, certified its denial under 28 U.S.C. § 1292(b), and this appeal followed.

Summary of Argument

The sale of residential apartments itself does not involve a sale of "securities" in any meaningful sense under the statutes or the cases which have applied the relevant statutory standards. Congress has itself rejected suggestions that real estate offerings and sales be made subject to "securities" regulation. The Securities and Exchange Commission has followed a similarly consistent policy. There can be an exception to the usual rule only when the transaction includes the presence of all of the elements of an "investment contract." Such elements are not pres-

ent here.[10] Accordingly, the facts at bar, the statute, Congressional intent and administrative policy all require reversal of the determination in the Court below. Sound judicial policy supports that view.

POINT I

The sale of real estate does not involve the sale of "securities."

Properly understood, the sale of the apartments in the case at bar was a sale of real estate. Sales of real estate as such do not logically or by statute constitute sales of "securities." In fact, the leading United States Supreme Court cases which furnish the basis under which some sales of real estate have been deemed securities affirm this simple proposition.

Securities and Exchange Commission v. *Howey Co.*, 328 U.S. 293 (1946), involved the sale of small interests in citrus grove acreage, in parcels amounting only to fractions of acres. Normally, there were simultaneously sold management arrangement contracts so that the purchasers, predominately nonresidents and persons with no knowledge or experience in citrus grove operations, could ultimately realize a return on the grove production. The Court held that as "investment contracts," these offerings required registration under the federal securities laws.

What is noteworthy here, however, is the assumption in the Court's opinion that the simple sale of real property would in no way be defined as a "security" within the meaning of the securities laws.

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[10] Another District Court Judge in the same District Court reached the conclusion which appellants here urge. *Forman* v. *Community Services, Inc.*, —— F. Supp. —— (S.D.N.Y. 1973), 72 Civ. 3980 (Slip Opinion #39805, September 6, 1973) (Pierce, D.J.). See *infra*, page .

> "The respondent companies are offering something more than fee simple interests in land, something different from a farm or orchard coupled with management services. They are offering [to] . . . persons [who] *have no desire to occupy the land* or to develop it themselves; they are attracted solely by the prospects of a return on their investment." 328 U.S. at 299-300 (emphasis supplied).

Thus, under *Howey,* persons with a desire to occupy the real property or real estate interests which they acquire and to make use of it themselves are not the subjects of offerings or sales of "securities." Both Congress and the Securities and Exchange Commission have so understood the leading case and policy involved.

An earlier Supreme Court case which similarly found federal securities laws to be applicable to real estate interest offerings proceeded from the same assumptions. *Securities and Exchange Commission* v. *Joiner Corp.,* 320 U.S. 344 (1943). In that case, the failure to register an offering of assignments of oil leases, joined with a drilling venture program, was held to be within the federal securities law proscription. In its application of the statutory terms, the Court's opinion clearly proceeds from the assumption that a "real estate" transaction is a class not normally within the confines of "investment" subject to regulation as "securities." 320 U.S. 344, 352 fn. 10.

Following these assumptions as well, Congress has refused to enact legislation which would have treated sales of real estate generally as sales of "securities." A review of the legislative history of several Congressional enactments confirms this policy assumption. Quite the contrary, it was not until *Howey* that the possible inclusion in the regulatory scheme of *any* land contracts was confirmed. The basically local and fixed nature of real estate and real estate interests was obviously a matter which Congress

determined should be left within the jurisdiction of state and local authorities.

When Congress did come to regulate some aspect of real estate sales, it did so in a manner which confirmed quite clearly the absence of its intent to consider such transactions as sales of "securities." In 1966, Sen. Bill No. 2672, denominated the Interstate Land Sales Full Disclosure Act, was proposed but enacted into law. That proposal would have given jurisdiction over certain land sales to the Securities and Exchange Commission. Commenting on the bill, the Commerce Department noted that it would add considerably to the costs of homesites and would be a burden to the SEC.[11] The Justice Department's comment was even more in point:

> "Real estate transactions traditionally have been regulated by the States in which the property is located. In our view, enactment of local legislation, utilizing existing state real estate commissions and incorporating the full disclosure provisions outlined in the bill, is the appropriate remedy." S. Rep. No. 1123, p. 198, 90th Cong., 2d Sess. (1968).

That recommended pattern, of course, is precisely the one in effect for the case at bar, where the offering was made only after compliance with the stringent filing and disclosure provisions of the New York Real Estate Syndication Act.

A bill similar to the 1966 proposal, again involving administration by the Securities and Exchange Commission, was likewise defeated in 1967 when proposed as Senate Bill No. 275. It was only in 1968 when a basic change in the proposal's administrative and logical focus was made that the Interstate Land Sales Full Disclosure Act, P.L. 90-448, 82 Stat. 590 (15 U.S.C. § 1701 *et seq.*), was

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[11] S. Rep. No. 1123, at p. 198, 90th Cong., 2d Sess. (1968).

passed and signed into law by the President. In the Act as passed, to the extent real estate transactions were regulated at all, jurisdiction was vested in the Department of Housing and Urban Development. The sales were not deemed a "security" to be regulated by the Securities and Exchange Commission. Congress thus considered and conclusively rejected proposals to treat sales of real estate as securities to be regulated by the SEC.

This change by Congress before passage of the law was no accident or inadvertence, for three Senators specifically criticized the proposed law for its placement of authority with the Housing Department and not the SEC. S. Rep. 1123, p. 197, 90th Cong., 2d Sess. (1965). Nevertheless, Congress followed its consistent pattern in its treatment of real estate interests and rights.[12]

The Securities and Exchange Commission, the administrative body charged with implementation of the statutory regulatory scheme for "securities," has been equally consistent in its approach to real estate to the "consumers" (so to speak) of such interests. It is, of course, well settled that the interpretation of a given regulatory scheme by the agency charged by statute with its implementation must be given substantial weight. *Skidmore* v. *Swift & Co.*, 323 U.S. 134 (1944); *Zeller* v. *Bogine Electric Manufacturing Corp.*, 476 F. 2d 795 (2d Cir. 1973).

A clear and relatively recent pronoucement on this subject by the SEC was set forth in its Securities Act Release No. 5347, issued January 4, 1973. In that release the Commission noted that while it spoke specifically in terms of condominiums—one of the forms of ownership provid-

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[12] A parallel analysis based upon implications from Congressional enactment of the Truth in Lending Act as bearing upon exclusions from the general definitions of the securities laws can be found in *McClure* v. *First National Bank of Lubbock, Texas*, 352 F. Supp. 454, 458 (N.D. Texas 1973).

ing for individual owners to participate in a larger structure[13]—"it applied to offering of all types of units and real estate developments which have characteristics similar to those described herein."

> "The offer of real estate as such, without any collateral arrangements with the seller or others, does not involve the offer of a security." Release No. 33-5347, CCH Fed. Sec. L. Rep. ¶ 79,163.

This policy announcement of the Commission gains even greater force when viewed against the background leading up to its promulgation. The Commission followed substantially the recommendation of its own Real Estate Advisory Committee. The Committee in a report issued late in 1972 had specifically urged the articulated common treatment of condominiums and cooperative apartment corporations for the purposes of the federal securities laws:

> "Cooperative dwelling units should be treated in substantially the same manner as condominium units inasmuch as the form of ownership is primarily a matter of local law and preference and represents no substantial difference with relation to the securities laws. In each case, in substance, real property is being transferred through a form of real property ownership which does not, of itself, create a security within the meaning of the 1933 Act. * * * The focus from the standpoint of the securities laws should be to separate housing opportunities properly subject to securities laws protection and not on forms of ownership." Report of the Real Estate Advisory Committee to the

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[13] Under condominium ownership, a filed declaration subdivides the fee ownership of the building structure so that each apartment owner actually holds fee title to his apartment. This form of ownership has been widely used in connection with resort area vacation homes but has now gained in popularity for more conventional residential structures.

Securities Exchange Commission, October 12, 1972, at p. 89.[14]

The Committee had urged the need for greater clarification in light of the uncertainty which resulted from the long-standing Rules promulgated earlier by the Commission. Rule 235, first adopted in 1961,[15] exempted from registration of any kind the sales of stock in cooperative housing corporations under certain nominal limiting conditions. The parallel Rule 15a-2, first adopted in 1947, exempted brokers who sold such stock from Commission registration procedures.[16] Absent a specific statement, there might be room for implication (as the Court below apparently implied) that the exemptions were required to dispense with registration for offerings otherwise subject to the securities laws. But such an argument by reverse implication would be clearly inconsistent with Commission policy over many years. The Commission has never made any announcement which would support such an argument or implication of such a determination. In fact, the Commmission has scarcely sought to enforce the stated limitations of either of the quoted rules and has simply not sought in any way to deal with apartment cooperatives. It is only where such cooperative owner-

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[14] Any other view would, in the light of the clear SEC position with respect to condominiums, impose a measure of uncertainty and fortuitousness with respect to the application of the federal securities laws. Thus, plaintiffs would presumably argue that the 15,000 purchasers in Co-Op City (*Forman* v. *Community Services, Inc., supra*), were entitled to protection under those statutes, but the equal number of offerees or purchasers in the Parkchester development, recently undergoing conversion to condominium ownership, require no such protection. The refusal of Congress to enact legislation placing real estate sales within the general pattern of the securities laws (see pp. 15-17, *supra*), requires that argument to be rejected.

[15] Adopted in Release No. 33-4305, January 9, 1961, 25 F.R. 12912.

[16] Release No. 34-3963, June 10, 1947, 13 F.R. 8177.

ship ventures, primarily as condominiums, have involved additional investment motivations (such as the contracts involved in *Howey*) that the Commission has made use of its enforcement and regulatory machinery. Where private residences were the object, no such action was ever deemed appropriate by the Commission. See Surftides Condominiums, CCH Fed. Sec. L. Rep. ¶ 78,685 (1972); Edward S. Jaffry, *Ibid.* ¶ 78,395 (1971); Clemson Properties, Inc., *Ibid.* ¶ 78,387 (1971).

In the face of this line of authority, the District Court erred in its conclusion that the SEC has not yet taken a "firm position" on the applicability of the securities laws to cooperative housing in the situations presented in the case at bar. In the opinion below, the District Court stated:

> "The position of the Securities and Exchange Commission, were it certain, would weigh on this Court's judgment." 365 F. Supp. at 1174.

The District Court failed to perceive the unequivocal position of the SEC. Instead, if the Commission's position is to be given its due weight, as the cases require and as the District Court apparently concedes, the preclusion of apartment cooperative interests for residence purposes should have been followed and federal jurisdiction not found to lie.

Both the texts and commentators, as well as state courts which have been called upon to make the classification of cooperative apartments under similar language of state security regulatory statutes, agree with the exclusion of such apartments constituting real estate from the concept of "securities." See 1 Loss, Securities Regulation, 491-92 (2d ed. 1961);[17] Miller, *Cooperative Apartments: Real Estate or Securities?*, 45 Bost. U. L. Rev. 465 (1965).

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[17] See p. 27, *infra*, where a portion of Professor Loss' opinion is set forth verbatim.

The state decisions have similarly treated a real estate sale transactions as mutually exclusive with a regulated security sale. *Brothers* v. *McMahon,* 351 Ill. App. 321, 115 N.E. 2d 116 (1953), rejected an effort to place cooperative apartment sales within the Illinois security regulation statute. *State* v. *Silberberg,* 166 Ohio St. 101, 139 N.E. 2d 342 (1956) made the same finding for Ohio, as did *State* v. *Hirsch,* 131 N.E. 2d 419 (Ohio Ct. App. 1956). *Willmont* v. *Tellone,* 137 So. 2d 610 (Fla. Dist. Ct. App. 1962) has reached the same result for Florida.

POINT II

The sale of cooperative residential apartments is sale of real estate; apartments are not "securities" and not "investment contracts."

The purchasers of apartments in the building in the case at bar were interested in those apartments for dwelling purposes. The apartments represented to them a real estate acquisition in the same way that the purchaser of an individual home in a suburban or rural area seeks to purchase a home. The purchasers sought the long-term stability of ownership as opposed to the uncertainty of tenancy under changing rent control statutes, the comfort of apartment living with similarly minded tenant-owners, the incentive to make their own long-term improvements and additions to the apartments, and the benefits afforded to home ownership under the Internal Revenue Code. In no meaningful sense whatsover did they seek to purchase "securities" for investment, appreciation, or return.

It was the proprietary lease which gave the individual apartment purchasers their rights. That document was and is clearly a real estate ownership document for persons who seek residence in their own apartments and have no concern, other than an incidental or passing one, in the

mechanics of its ownership. Clearly, an investor in a securities transaction would scarcely contemplate the possibility that his investment might be terminated by permitting a visit from a person of "dissolute, loose or immoral character" (Lease, ¶ 34(e), App. 134a). This is the concern of a resident, not an investor.

A. The Decisions Reject the Use of a "Mechanical" Test

The cases which have applied the detailed listings of definition of "security" for the purposes of the Securities Act of 1933[18] and the Securities Exchange Act of 1934[19] have always been clear that mere "mechanical" application of the words of the statutory definition is inappropriate.[20] The mere denomination or appellation of a given document as a "note" or as "stock" is inadequate. The intent and purpose of the document involved and the transaction in which it is delivered must be examined in order to determine whether the transaction involves a "security" within the meaning of the federal securities law.

In dealing with definition and scope problems of the federal securities law, the Supreme Court has consistently taken this approach. Thus, in *Tcherepnin* v. *Knight,* 389 U.S. 332 (1967), the Court said:

> "Finally, we are reminded that, in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality. S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298 (1946)." 389 U.S. at 336.

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[18] 15 U.S.C. § 77b(1).

[19] 15 U.S.C. § 78c(a) (10).

[20] The definition of the term "security" is virtually identical in the 1933 and 1934 Acts, and for the purposes of this litigation, the statutes are treated *in pari materia. Tcherepnin* v. *Knight,* 389 U.S. 332, 335-36 (1967).

In the earlier *Howey* decision, the Court had likewise reached the conclusion in its analysis of the term "investment contract" that emphasis be placed on "economic reality."[21]

Even earlier, in *Joiner Corp.*, the Court had noted that:

> "The test rather is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as this it is not inappropriate that promoters' offerings be judged as being what they were represented to be." *S.E.C.* v. *Joiner Leasing Corp., supra,* at 352-353.

Admittedly, in *Tcherepnin, Howey* and *Joiner,* the search for underlying economic reality led the Court to include in the ambit of the statutory definition a transaction which might not linguistically or mechanically be included at first blush. This was true for an investment contract in citrus groves in *Howey,* for capital share certificates of a savings and loan association in *Tcherepnin,* and for assignments of mineral leases in *Joiner.* The thrust of the required analysis is to go beyond mere words, however. Whether or not this search requires affirmative inclusion as in the cited cases, the same economic analysis must be applied in a preclusionary manner if circumstances so require, as in the case at bar.

Other decisions have similarly and consistently required such analysis and application, looking to the substance of the transaction and the relationship of the parties, rather than the mere title or label affixed to the instruments at bar. *S.E.C.* v. *Universal Serv. Ass'n.,* 106 F. 2d 232 (7th Cir. 1939); *Mincolla* v. *Arthur-Hardgrove Co.,* CCH Fed. Sec. L. Rep. ¶ 91,608 (S.D.N.Y. 1965). For similar results, see *Lehigh Valley Trust Co.* v. *Central National Bank of Jack-*

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[21] *Securities and Exchange Commission* v. *Howey Co.,* 328 U.S. 293, 298 (1946).

sonville, 409 F. 2d 989 (5th Cir. 1969); *City National Bank of Fort Smith, Arkansas* v. *Vanderboom,* 422 F. 2d 221 (8th Cir. 1970); *Clement A. Evans & Co.* v. *McAlpine,* 434 F. 2d 100 (5th Cir. 1970); *Joseph* v. *Norman's Health Club, Inc.,* 336 F. Supp. 307 (E.D. Mo. 1971); *McClure* v. *First National Bank, supra.*

At no time do the cases suggest that a mere mechanical reading is mandated or adequate. In its affirmance in *Movielab, Inc.* v. *Berkey Photo, Inc.,* 452 F. 2d 662 (2d Cir. 1971), this Court itself so held by implication. In that case, the District Court in its opinion, 321 F. Supp. 806 (S.D.N.Y. 1970, per Mansfield, D.J.), had concluded that it lacked discretion to preclude certain promissory notes from the statutory ambit since all notes were necessarily included in the statutory phase "any note." This Court noted that the term "any note" "includes *some* notes at the very least." 452 F. 2d at 663. This Court did not take the position that the mere use of the word "note" was enough to place it within the statute. It pointed to a decision in another circuit which had held that "*almost* all notes are held to be securities." *Lehigh Valley Trust Co.* v. *Central Nat'l Bank,* 409 F. 2d 989, 992 (5th Cir. 1969); 452 F. 2d at 664 (emphasis added).

Another District Court has summarized the approach reflected in these cases in the following language:

> "Courts have not given this section an absolutely literal interpretation . . . and most federal courts . . . have construed the statute broadly enough so 'almost all notes are held to be securities.' Lehigh Valley Trust Co. v. Central National Bank of Jacksonville, 409 F. 2d 989, 992 (5th Cir. 1969)." *McClure* v. *First National Bank,* 352 F. Supp. 454 (N.D. Tex. 1973).

In its *Movielab* decision, this Court's analysis of the leading Supreme Court cases with respect to the word

"note" is the same as is being urged by appellants herein. This Court should now easily reach the same result with respect to the word "stock" in the case at bar.

The contrary suggestion in the opinion of the Court below would yield a rote reading of the statute. The mere title to a document as "stock," regardless of its economic or relationship import, would apparently satisfy the District Court's approach below. Such mechanical formalism has been rejected by the Supreme Court in all of its relevant opinions, and in later cases in the lower courts which have followed the Supreme Court's guidelines.

The Court below erred in failing to look beyond the mere appellation of the title instrument in the real estate transaction. For this reason, this Court should reverse the District Court's holding that any instrument bearing the appellation "stock" is in each and every case a security, regardless of the reality of the transaction.

A careful reading of the Plan and Lease (see pp. 5-12, *supra*), will demonstrate the economic realities involved here. It was the Lease, correctly termed a "proprietary lease," which governed the future conduct of the joint ownership of the building structure in which the individual apartments were located. Thus, while the "stock" was nominally non-assessable under the terms of the Business Corporation Law (App. 109a), in reality, annual additional assessments for "maintenance" or "rent" were to be made under the "cash requirements" section of the Lease (App. 115a-116a). Clearly, such an arrangement is not characteristic of "stock" properly within the ambit of the federal securities laws.

Other provisions of the dominant document, the Lease, are equally inconsistent with the concept of "securities." Not only was transferability restricted, but there could be no possible participation or subdivision in equity ownership (App. 118a-119a). Again, the inconsistence of such economic reality with the concept of "stock" or "securities" is apparent.

Instead, this Court should view the transaction involved in this case in light of the test for an investment contract, as promulgated in *Howey* and subsequent authority, to determine if a security is involved in the instant case. This is the manner in which the problem has been considered by the federal courts, the SEC, and serious writers on the subject.

B. The Apartments Sold Were Not "Investment Contracts."

The inquiry into economic reality and substance thus mandated disposes as well of the set of tests established in *Howey* for the finding of an "investment contract." The three-fold test first laid down in that decision requires that there be found a common enterprise, expectation of profits and reliance upon the primary efforts of a third-party promoter.[22]

Whether or not there exists a "common enterprise" of the kind envisaged in *Howey,* it is clear that the profit expectation test and that of the third-party efforts cannot be met in a cooperative residential apartment building.

First, as to the "profit" requirement, one commentator has summarized a review of the cases on this point thusly:

> "In most apartment cooperatives there is no hope of profit. In the handful of reported cases, the courts have said in effect that what is sold is actually real estate, that the corporation exists to make real estate ownership convenient and that the purpose of buying stock is not for profit but for home ownership." Miller, *supra,* at 467-68.

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[22] "In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." 328 U.S. 293, 298-99.

An investment for profit, in any purchase, must necessarily involve, in the *Howey* sense, something beyond the mere general appreciation in value. Neither Congress nor the Court intended to incorporate the theories of Henry George into the federal securities laws and thus make any and all sales of real estate a "security" sale. A United States District Court in *Contract Buyers League* v. *F & F Investment,* 300 F. Supp. 210 (N.D. Ill. 1969), specifically rejected such an argument. There, the Court was asked to classify contracts to purchase private residences as "securities." The District Court quoted Professor Loss to the effect that:

> "No 'investment contract' is involved when a person invests in real estate, with the hope perhaps of earning a profit as the result of a general increase in values concurrent with the development of the neighborhood, as long as he does not do so as part of an enterprise whereby it is expressly or impliedly understood that the property will be developed or operated by others. 1 Loss, Securities Regulation 491-92 (2d ed. 1961)." 300 F. Supp. at 224.

The Court then continued:

> "[P]laintiffs, at the time of purchase, intended to acquire personal residences. To conclude that the natural desire of any purchaser that his purchase should appreciate in value makes a 'security' of what has been purchased, is obviously to so muddle the term as to make it meaningless." 300 F. Supp. at 224.

Such purchases, if they involve "profit" in any sense, are "the profits of the homeowner rather than of an investor in corporate activity." Note, Cooperative Housing Corporations and the Federal Securities Laws, 71 Colum. L. Rev. 118 (1971); see *Eckstein* v. *United States,* 452 F. 2d 1036 [Ct. of Claims] (1971); *Forman* v. *Community Services, Inc., supra,* p. 35, n. 35.

The District Court relied on two other elements in its effort to force the case at bar into the *Howey* mold, and thus convert real estate sales into "securities" transactions.[28] First, it argued that the availability of tax benefits to owners of cooperative apartments represented a "profit" expectation. Such an argument proves too much for it would make the purchase of any and every home or residence one involving a "security." Congress, in enacting § 216 of the Internal Revenue Code relating to cooperative housing, intended to equate the ownership of apartments for tax purposes to the ownership of homes. Congress did not intend to force such apartment sales into the statutory framework of securities regulation. See *Contract Buyers League* v. *F & F Investment, supra.* As noted earlier, Congress has specifically considered and rejected treating real estate sales as securities. See pp. 15-17, *supra.* The appellation of the term "profit" to anticipated tax benefits strains and distorts the common sense usage of the term and takes it far beyond anything envisaged by *Howey* and its progeny.

Similarly strained is the reliance for the "profit" element of *Howey* by the Court below on the possible income from nonresidential space, used to offset maintenance costs otherwise collectible from tenant-owners. Such anticipation was necessarily a limited one since the relevant provisions of the Internal Revenue Code restrict amounts which may be received by a qualified cooperative housing corporation from sources other than proprietary rents, i.e., the contributions of the tenant-owners to the common

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[28] The assertion made by plaintiff below and adopted by the District Court that any economic benefit constitutes a "profit" is hardly a new or novel idea. The state courts in California, in *Silver Hills Country Club* v. *Sobieski,* 55 Cal. 2d 811, 361 P. 2d 906 (1961) have adopted this view. Although upon numerous occasions federal courts have been urged to adopt the reasoning of *Silver Hills,* they have uniformly refused to do so. See *Forman* v. *Community Services Inc., supra* at p. 23.

expenses. The facts themselves, as reflected in the offering plan, support the conclusion that this could hardly have been thought as a "profit" motive in the normal sense, where it was anticipated that from an annual maintenance budget of $372,180, only $24,500 or six (6) per cent, could be collected from persons other than tenant-owners (App. 80a). To consider such matters as profit for the *Howey* test would convert into "securities" any home purchase in a homeowner association or condominium where the income from a cigarette vending machine or jukebox was to be used to offset group expenses. To adopt the approach suggested by the District Court, would make the applicability of the securities laws to residential cooperative apartments almost accidental or fortuitous. Many residential apartment buildings have virtually no non-residential space; others may have substantial commercial space, such as doctors' offices, restaurant locations, or stores. Some buildings might have laundry machine facilities which yield a "profit"; other buildings would operate such facilities on service basis. Clearly, the determination of the appropriate forum and statutory standard should not be the result of such accidental factors. Such a result is obviously neither required not logical under the statutes.

The language and context of *Howey* make it clear that the reliance on others which is required is to be found in the context of the common enterprise and expected profit-making of the venture. In other words, those on whom reliance is to be placed must be somehow related to, or involved in, the creation of the profits which the investors who purchase "securities" anticipate. The existence of "reliance" without the anticipation of "profits" is meaningless. Similarly, "reliance" on those unrelated to profit-making efforts is inconclusive under the *Howey* tests. It is no more than the reliance by an investor on his attorney or accountant in connection with an investment.

The District Court purported to find the required reliance under the "conversion" to cooperative real estate

ownership in three ways. The Offering Plan sponsors established "financial arrangements and general guidelines," said the opinion below. In doing so, they did nothing more or less than any builder or real estate subdivider would be required to do to effect sales of residential units. Again, such an analysis so extends the concept of "reliance" as to make it meaningless. Obviously, owners of real estate seeking to sell it will have been involved with its management and control prior to the effective date of the sale. If prior management alone satisfies the "reliance" test, then any object owned and then sold will be deemed to be a "security." The reasoning expressed in *Howey* and the later cases, which is the basis for and as summarized in the Securities Act Release of January 4, 1973, requires that there be "reliance" *after* the transfer or purchase.[24] The Court in *Howey* looked to the citrus management *after* the sales, not to any prior cultivation or subdivision efforts. The Court in *Joiner* focused on the drilling program *after* the lease assignments, not to any activity in the creation of the assignable lease interests.

The right given to the sponsors to step into the shoes of purchaser, absent outside purchasers of specific apartments, hardly involves "reliance" for the purpose of creating profits to investors. The contingent rights were to provide access to information and prevent financial changes in the operation of the building until all the apartments were sold by those to whom control of the venture was to be given—the representatives of the tenant-owners themselves—that this provision, which was *never* implemented in any event, was designed. This seems to be the reverse of "reliance" for "profit" required under *Howey*.

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[24] Thus, the Release deals with pooling arrangements for seasonal rent of apartments, exclusive rental service agreements, or similar arrangements for continued managerial control after the nominal transfer of title.

Finally, the advance arrangements, relating to the format and framework for the sale of the apartments, which are fully described, *supra,* at pp. 5-12, are equally unrelated to any "profit" anticipation by purchasers or investors and do not constitute any form of "reliance." To hold otherwise would require that the builder and his subcontractors in any multi-unit housing development had by their preparation of structures, mortgages, deeds, and the like, created "securities" by their efforts. Such result is as unrequired as it is illogical.

It would be helpful to look to the nature of the contracts which the District Court implied had so tainted the conveyance as to meet the necessary *Howey* test. The opinion below itself mentions the management contract with a third-party firm, which took over the management as agent on behalf of the tenant-owners and excluding the former owner-sponsors at the time of the closing. Was the "reliance" on the new management firm? Or on the former owners? Who "relied" on whom for whose "profit"?

One other contract may be said to have had any substance. It related to a previously negotiated commitment for electrical work within the building at fixed prices for specified upgrading. Again, for whose "profit" was that "reliance" intended? Did it benefit the electrical contractor, or the tenants? The former owners had no interest in the matter and their efforts in making the arrangements, as in the case of the management contract, was solely to facilitate the transfer of operational control to the new tenant-owners without precipitate changes or confusion.

The remaining of the "at least nine contracts," to which the District Court points in such dismay, were of such small substance or weight as to scarcely bear the burden of argument which the opinion below would impose upon them under the *Howey* test. They included *terminable* contracts for maintenance or services with exterminators, a cable television company, an elevator maintenance com-

pany, a coin operated laundry contract and a water services contract.[25]

While stating the need for an analysis of economic "reality," the District Court's opinion scarcely does so. Quite the contrary, its efforts to force the fact situation here presented into a Procrustean bed of compliance with *Howey* loses sight of the realities which are actually presented.

POINT III

The District Court erred in its mechanical application of statutory language, in its failure to follow clear SEC policy interpretations as supported by Congress, and its refusal to follow an earlier decision in the same District.

The District Court apparently felt itself bound by the fact that part of the title documents transferred to purchases was denominated "stock." Such a mechanical test is neither required nor appropriate.

In doing so, the District Court characterized the enunciated positions of the Securities and Exchange Commission in a manner inconsistent with their treatment by Congress and the courts. That was equally improper.

Apparently itself recognizing the infirmity of the first branches of its opinion, the District Court then went on to find compliance with the *Howey* tests, distorting those facts beyond the ordinary and common sense meaning of the terms and words employed.

None of these errors had been made in another decision in the same District only a short time prior to the decision below. That decision was by Pierce, D.J., in *Forman*

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[25] A full description of these contracts is printed in the Offering Plan (App. 97a).

v. *Community Service, Inc.*, —— F. Supp. —— (S.D.N.Y. 1973); 73 Civ. 3980 (Slip Opinion No. 39805, Sept. 6, 1973). In that case, with which District Judge Stewart differed in his opinion below, the Court correctly analyzed all of the test components which should be properly applied here. The Court in *Forman* clearly rejected any mechanical test based on the use of the word "stock" or any other word.

> "[T]his Court must, at a minimum, look through the name of an instrument to its essential characteristics and determine whether it fits the standardized, well-settled meaning of 'stock.'" Slip. Op. at p. 18.

The Court in *Forman* then went on to recite the policy development, as reflected in the previously discussed SEC announcements with respect to real estate sales and offers.[26] Finally, the Court in *Forman* pointed out the inapplicability of the *Howey* tests of "investment contract" to a cooperative housing situation.

> "As attractive as that reasoning may be, Supreme Court cases and the lower federal court cases which follow them closely, and legislative documents concerning the federal securities laws convince this Court that the weight of authority is against it. This Court has attempted to follow the guiding principle that federal securities laws, as remedial legislation, must be read liberally to effectuate the purpose of Congress, *Tcherepnin* v. *Knight, supra* at 336, and is mindful that to further the objectives of Congress, the securities laws must be viewed as embodying a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of money of others on the promise of profits. *S.E.C.* v.

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[26] *Forman* v. *Community Service, Inc., supra*, Slip Op. p. 40-41, n. 44.

Howey, supra at 299. Yet, it seems certain that Congress never intended to stretch the scope of the securities acts outside the commercial world and its fungible valuables, to the uncharted and unchartable realm of intangible, elusive personal values where one man's balm may very well be another's bane.

"The legislative history of these acts, on the contrary, indicates that the intentions of Congress were focused on the powerful inducement of cold, hard cash and anything which could be converted to it through the commercial ingenuity of man. It is the abuse of this inducement, this motive, from which Congress believed investors needed protection, both for their well-being and for the health of the nation's commercial enterprises and its economy." Slip Op. at pp. 24-25.

The District Court below casually dismissed the applicability of the reasoning in Judge Pierce's opinion by a claim that the "elements of state control and non-profit made [*Forman*] materially different." This disregards the detailed policy analysis offered by Judge Pierce and, in light of the strained definition given to the concept of "profit" in the opinion below, it is hardly adequate grounds for distinction. Similarly, the "state control" present in *Forman* is an inadequate basis for distinction. If such "control" by local authority is to become the touchstone, then the compliance procedures imposed under the Real Estate Syndication Act are appropriate to that task.

Moreover, it may be noted that even if it should be determined on appeal to this Court that the *Forman* decision is erroneous, there are adequate factual distinctions which would remain to support reversal here even in the face of reversal in *Forman.*

In *Forman,* the sales of apartments were made to over 15,000 purchasers (and presumably more offerees) who

were by definition in limited income brackets, and offered apartments in structures to be newly constructed. Nonetheless, Judge Pierce found the federal securities laws inapplicable. In the case at bar, the sales were made of apartments in an existing structure, to approximately 60 purchasers, many of whom had lived in their apartments in the building for many years, and who were persons in an economic bracket where the availability to them of legal, accounting, or real estate professional advice might be more readily assumed. Thus, even if the equities should require that the numerousness of purchasers and offerees and their posture in *Forman* brings that case within the federal securities law, there are no such compelling reasons present here and reversal of the District Court determination would remain appropriate.

POINT IV

Sound judicial policy and administration require that plaintiffs' complaint be dismissed as jurisdiction of this matter should remain in the state courts.

The Court below correctly noted that this is a case of first impression.[27] Although the cooperative form of apartment ownership has been in common use for many years, until now the issue presented here has never previously been decided by a federal court at either the trial or appellate level.

This lack of precedent is significant. It offers the clear implication that heretofore litigants have correctly treated the sale of residential apartments as sales of real estate, not of securities. As noted *supra,* fns. 2-3, in New York City alone there have been numerous cooperative housing units sold since the enactment of the federal securities laws. From these sales have arisen many disputes and

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[27] 365 F. Supp., at 1173.

much litigation. Yet, neither plaintiffs nor the District Court can point to a single instance in which a federal court has held that a transaction such as this constitutes a sale of securities under the federal securities laws.

During that period of time, an extensive number and variety of actions have been tried. They have involved all manner of disputes over offerings, sales, rights, or representations. Yet, they uniformly treated real estate sales as what they are. Those litigants recognized, as appellants here contend, that this dispute can be fully and fairly determined between the parties in a proceeding in the courts of the State of New York. To burden the federal courts with an unnecessary burden of litigation involving real estate matters, traditionally and essentially a concern of state governmental agencies and courts, on the basis of mechanical analysis of statutory language is not a result intended by Congress, nor would it be consistent with judicial or administrative interpretation, or faithful to the federal system of concurrent jurisdiction.

As shown by its enactment of the Interstate Land Sales Full Disclosure Act, discussed *supra*, at pp. 15-17, Congress when it intends to do so specifically and directly requires federal regulation of real estate transactions. If the sale of real estate is to be brought within the ambit of the federal securities laws, it must be accomplished by the Congress. Judicial restraint requires that the federal judiciary recognize that the unprecedented expansion of the term "security" to include commmon, everyday real estate transactions is the province of Congress.

CONCLUSION

For the reasons given, the order and opinion of the District Court should be reversed and the matter remanded with directions to dismiss the pending complaint.

Respectfully submitted,

March 14, 1974.

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